IN THE STATE OF SOUTH CAROLINA

In the Court of Appeals

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SC Court of Appeals

APPEAL FROM BERKELEY COUNTY
Court of Common Pleas

Kristi Lea Harrington, Circuit Court Judge

Case No. 2013-CP-08-00179

Ex Parte:

Nationwide Mutual Fire Insurance Company, ...Appellant,

In Re:

Beresford Commons Homeowners Association, Inc.,.....Respondent,

v.

Superior Solution, LLC, ...Respondent.

APPELLANT'S INITIAL BRIEF

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TABLE OF CONTENTS

Page Number

TABLE OF AUTHORITIES

CASES

STATUTES AND COURT RULES

Page Number

SECONDARY AUTHORITIES

Page Number

STATEMENT OF ISSUES ON APPEAL

I. Does Harleysville Group Ins. v. Heritage Cmties., Inc., *et al.*, 2017 WL 105021, Op. No. 27698 (S.C. Sup. Ct. filed Jan. 11, 2017) (Shearouse Adv. Sh. No. 2 at p. 21), require a liability insurer to intervene in the underlying action to establish liability against its insured if it seeks to establish the facts necessary to allocate between covered and non-covered damages?

II. Did Harleysville constitute a change in law such as to require a liability insurer to intervene in the underlying action where such intervention was not previously required?

III. Did the trial court err in refusing to hear Nationwide's Motion to Intervene?

IV. What are the are the procedural and evidentiary rules going forward if intervention is required?

STATEMENT OF THE CASE

This is an appeal from two rulings by the Honorable Kristi Lea Harrington, Circuit Judge of the Ninth Judicial Circuit, that effectively denied Appellant Nationwide Mutual Fire Insurance Company's (hereinafter "Nationwide") Motion to Intervene due to a recent change in law governing insurance coverage litigation. By Form 4 Order filed January 31, 2017, the trial court ruled that Nationwide's Motion was not heard because it was filed after the pretrial deadline. On February 6, 2017, Nationwide's Motion for Reconsideration and/or to Alter or Amend was denied by a ruling from the bench at a pre-trial hearing.

This action was originally filed on or about January 23, 2013 as a construction defect action involving a residential development located in Berkeley County known as Beresford Commons. (Complaint.) The defendants were Portrait Homes-South Carolina, LLC, Portrait Homes-Beresford Commons, LLC, and Pasquinelli Homebuilding, LLC (hereinafter collectively "Portrait Homes") the developer / general contracting entities. The Complaint was subsequently added to name Superior Solution LLC (hereinafter "Superior Solution") as a defendant. (Amended Complaint.) Superior Solution was served on approximately August 30, 2013. (Affidavit of Service.)

The plaintiff in this action is Respondent Beresford Commons Homeowners Association, Inc. (hereinafter "the HOA"). A companion class action by the unit owners has been settled and dismissed. (See Seventh Amended Complaint, Joseph Costantini and Susan M. Costantini, on behalf of themselves and other similarly situated vs. Portrait Homes-South Carolina, LLC, *et al.*, Civil Action No. 2013-CP-08-00180.)

The operative pleading when Nationwide moved to intervene was the HOA's Sixth Amended Complaint, which was filed on July 27, 2015. (Sixth Amended Complaint.)

Portrait Homes filed an Answer and Cross-claims against Superior Solution for indemnity. (Portrait Homes Answer and Cross-claims filed Aug. 10, 2015.) The HOA filed its Seventh Amended Complaint in this action on January 5, 2017. (Seventh Amended Complaint.)

The HOA alleged in their Seventh Amended Complaint that Superior Solution was responsible for installation of the siding during original construction of the Beresford Commons project. (Seventh Amended Complaint, ¶ 10.) Many other siding installer defendants were named in the lawsuit. The HOA asserted causes of action for negligence, breach of warranty, and unfair trade practices. (Id. at ¶¶ 9, 24-42.)

Nationwide retained Albert A. "Andy" Lacour of Clawson and Staubes, LLC to defend Superior Solution in this action. Lacour continues to represent Superior Solution up through the present time.

Nationwide filed a separate declaratory judgment action in federal court on February 10, 2016 to determine its coverage for any judgment or settlement awarded against its insureds. (See Complaint, Nationwide Mut. Fire Ins. Co. v. Superior Solution, LLC, *et al.*, Case No. 2:16-cv-423-PMD (hereinafter "the coverage DJ").) In the coverage DJ, Nationwide alleged it issued two policies of liability insurance to Superior Solution. (Id. at ¶¶ 11-12.) Nationwide requested declarations that, among other things, liability for defective work is not covered under its policies. (Id. at ¶¶ 34-36, 47-49.)

Due to an interlocutory appeal by the HOA, the coverage DJ was stayed until February 10, 2017. (Mandate.) During that time, the Supreme Court of South Carolina issued its opinion in Harleysville Group Insurance v. Heritage Communities, Inc., *et al.*, 2017 WL 105021, Op. No. 27698 (S.C. Sup. Ct. filed Jan. 11, 2017) (Shearouse Adv. Sh.

No. 2 at p. 21). Nationwide moved to intervene in this action based upon change in law on January 26, 2017. (Nationwide Motion to Intervene.)

When Nationwide moved to intervene, the HOA served written discovery requests on Nationwide and noticed Nationwide's deposition pursuant to Rule 30(b)(6), SCRCP. (See Nationwide's Motion for a Protective Order, Exh. A and B.) Nationwide moved for a protective order as to the HOA's requested discovery because Nationwide sought intervention only for the limited purpose of drafting and submitting a special verdict form or special interrogatories to the jury pertaining to certain coverage questions. (Id. at p. 3.)

Counsel for Nationwide raised both motions to the trial court at a hearing held on January 31, 2017. (Transcript of Record dated Jan. 31, 2017 at pp. 6-8.) The trial court refused to hear Nationwide's Motion to Intervene, finding it was not timely filed. (Form 4 Order filed Jan. 31, 2017.) The HOA withdrew its requests for discovery and a deposition of Nationwide after Nationwide's Motion to Intervene was not granted. (Transcript dated Jan. 31, 2017 at p. 8.)

Nationwide served its Motion for Reconsideration and/or to Alter or Amend on February 2, 2017 and filed it on February 6, 2017. (Nationwide Mot. for Reconsideration.) Counsel for Nationwide requested that the trial court advise as to whether its ruling on Nationwide's Motion to Intervene was final. (E-mail dated Feb. 2, 2017.) The HOA served a memorandum in response to Nationwide's Motion for Reconsideration on February 3, 2017 and filed it on February 7, 2017. (Pl's. Mem. in Opp'n.) Nationwide served its Reply Memorandum on February 3, 2017 and filed it on February 6, 2017. (Reply Mem.) The trial court scheduled a hearing on Nationwide's Motion for Reconsideration for February 6, 2017. (E-mail dated Feb. 4, 2017.)

At the hearing, the trial court ruled from the bench that Nationwide's Motion to Intervene was denied. (Transcript of Hearing dated Feb. 6, 2017 at pp. 16-17.) Nationwide filed and served its Notice of Appeal on the same date. (Notice of Appeal.)

STANDARD OF REVIEW

This Court exercises *de novo* review of questions of law. Fesmire v. Digh, 385 S.C. 296, 302, 683 S.E.2d 803, 807 (Ct. App. 2009).

ARGUMENT

This appeal concerns legal questions regarding intervention by a liability insurance carrier into an underlying tort action pursuant to Rule 24, SCRCP. The specific issue on appeal is whether Nationwide's motion to intervene was timely due to a recent change in law. However, the larger issues concern whether intervention by a liability carrier into an underlying tort action is required or permitted, and if so, upon what basis, to what extent, and by what procedure.

In this case, the HOA's tort claims pertaining to alleged construction defects and Nationwide's contractual coverage questions were proceeding in two separate actions. However, Nationwide was forced to intervene in this action in order to protect its due process rights when the Supreme Court issued its opinion in Harleysville, 2017 WL 105021.

I. The trial judge erred in ruling that Nationwide's motion to intervene was untimely because intervention was mandated by a change in law.

Nationwide moved to intervene in this action based upon a fundamental change in South Carolina law that appears to require intervention by a liability insurer where no such intervention was previously required. (Motion to Intervene at ¶ 11-19.) The trial judge ruled that Nationwide's motion was not timely because it was filed after the pretrial

deadline. (Order filed Jan. 31, 2017.) Therefore, the question presented in this appeal is whether the Harleysville opinion constituted a change in law such that the trial court erred in refusing to hear Nationwide's motion to intervene.[1]

A. State law prior to Harleysville

Liability insurance generally provides counsel to defend the insured and indemnification of the insured defendant for any judgment awarded against the defendant. Sloan Const. Co. v. Cent. Nat. Ins. Co. of Omaha, 269 S.C. 183, 186, 236 S.E.2d 818, 820 (1977). The Fourth Circuit has aptly summarized the tripartite relationship between the plaintiff in a tort action, the defendant in the tort action, and the defendant's liability insurer. In Twin City Fire Insurance Company v. Ben Arnold-Sunbelt Beverage Company of South Carolina, LP, the court explained:

> When a party with insurance coverage is sued, the insured notifies the insurance company of the suit. The insurance company, in turn, typically chooses, retains, and pays private counsel to represent the insured as to all claims. If the suit involves some claims that are covered under the insurance policy and some claims that are not covered, the insurance company typically will send a reservation of rights letter to the insured stating what claims the insurance company believes are covered and what claims it believes are not covered.

433 F.3d 365, 367 (4th Cir. 2005).

When coverage issues exist, there are two separate disputes: (1) the underlying action brought by the plaintiff to establish liability against the insured defendant, which

[1] Nationwide recognizes that Harleysville is not a final decision. Nevertheless, the filing of the Harleysville opinion could not be ignored because the court based its holding on implied waiver. The Supreme Court held that Harleysville waived its coverage position based upon deficiencies the court found in reservation of rights letters dated 2003 and 2004 and Harleysville's failure to seek an allocated verdict in the underlying case. Harleysville, 2017 WL 105021 at *6-7 and n.11. The change in the law required Nationwide to move to intervene in order to avoid an implied waiver.

generally sounds in tort (hereinafter "the tort action"), and (2) the question of liability coverage for the claims against the defendant.

The plaintiff's tort claims against the defendant contractor in a construction defect action depend upon a finding that the contractor violated applicable building codes, deviated from industry standards, or constructed housing that the builder knew or should have known posed a serious risk of physical harm. Kennedy v. Columbia Lumber & Mfg. Co., Inc., 299 S.C. 335, 347, 384 S.E.2d 730, 738 (1989). On the other hand, coverage issues turn on interpretation of the insurance contract between the contractor and the insurer. B.L.G. Enters., Inc. v. First Fin. Ins. Co., 334 S.C. 529, 535, 514 S.E.2d 327, 330 (1999). Whereas underlying tort actions are factually driven, interpretation of insurance contracts is an issue of law for the court. Bennett & Bennett Constr., Inc. v. Auto Owners Ins. Co., 405 S.C. 1, 4, 747 S.E.2d 426, 427 (2013).

There is an inherent tension between a liability insurer's duties to its insured and its protection of its rights under the insurance contract. Liability insurers owe a duty of good faith and fair dealing in defending their insureds in the underlying tort action. Tyger River Pine Co. v. Maryland Cas. Co., 170 S.C. 286, 170 S.E. 346 (1933). However, liability insurers also "have the right to limit their liability and to impose conditions on their obligations provided they are not in contravention of public policy or a statutory prohibition." B.L.G., 334 S.C. at 535, 514 S.E.2d at 330. A contrary holding would result in a total disregard for the policy language and would expose insurers to unlimited liability which, in turn, would result in unaffordable premium rates.

In construction defect cases, coverage disputes are almost unavoidable. This is because of the nature of the insurance contract and applicable statutes. Standard form

liability insurance policies (absent exclusions) cover property damage caused by an accident, but they do not cover defective work. Isle of Palms Pest Control Co. v. Monticello Ins. Co., 319 S.C. 12, 459 S.E.2d 318 (Ct. App. 1994), aff'd, 321 S.C. 310, 468 S.E.2d 304 (1996).[2] When water intrusion caused by construction defects is alleged, the accident is the unforeseen water intrusion. Liberty Mut. Fire Ins. Co. v. J.T. Walker Indus., Inc., 835 F. Supp. 2d 104, 107 (D.S.C. 2011). Coverage exists for otherwise non-defective building components that are damaged as a result of accidental water intrusion caused by defective work, but not for the defective work itself. Crossmann Cmties. of N.C., Inc. v. Harleysville Mut. Ins. Co., 395 S.C. 40, 50, 717 S.E.2d 589, 594 (2011).

This distinction is not only mandated by the policy language and governing case law, it is also codified by statute. S.C. Code Ann. § 38-61-70(B)(2). The construction industry, which lobbied for the enactment of this statute, should not be heard to demand that it be disregarded.

Therefore, the scope of liability coverage is limited in most construction defect cases. As a matter of law, coverage exists for those otherwise non-defective components within the insured contractor's work that were damaged by accidental water intrusion, but not for the defective work itself. In many policies, exclusions also apply.

Different states have developed different methods of dealing with this inherent tension in liability coverage relationships. Some states disregard policy provisions that allow insurers to control the defense and permit insureds to retain independent counsel at the liability carrier's expense when coverage issues arise. See Twin City, 433 F.3d at 371.

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[2] Nationwide's policies define "occurrence" as "an accident, including continuous or repeated exposure to substantially the same general harmful conditions." (Nationwide policies, Form ACP-0007 (11-04) at p. 12, attached to Mot. to Intervene.)

These states destroy an insurer's ability to control defense costs and reduce insurers to little more than a funding source. Other states allow insurers to control the defense, but require insurers to instruct defense counsel to request special interrogatories or a special verdict at trial to clarify coverage questions. Magnum Foods, Inc. v. Continental Cas. Co., 36 F.3d 1491, 1498 (10th Cir. 1994). These states intermingle insurance issues with the underlying tort case. South Carolina courts developed another means of addressing coverage questions—one that was consistent with other applicable law and that provided a workable solution.

1. Insurers' "control" of the defense

Under prior South Carolina law, when an insurer reserved its rights as to coverage issues, it retained defense counsel whose loyalty was solely to the insured. Twin City Fire Ins. Co. v. Ben Arnold-Sunbelt Beverage Co. of S.C., LP, 336 F. Supp. 2d 610, 615-16 (D.S.C. 2004). The liability insurer then retained separate coverage counsel to represent the insurer's interest in protecting its coverage position. This method avoided creating a conflict of interest for counsel retained to defend the insured. Defense counsel had no conflict because insurance coverage was addressed in separate litigation.

2. Separation of coverage issues from underlying tort issues

Under longstanding South Carolina law, insurance coverage issues are separated from tort issues. Under the common law, liability insurers may not be joined as parties in tort actions with their insured defendants. Major v. Nat'l Indem. Co., 267 S.C. 517, 520, 229 S.E.2d 849, 850 (1976); Trancik v. USAA Ins. Co., 354 S.C. 549, 554, 581 S.E.2d 858, 861 (Ct. App. 2003). Plaintiffs in underlying tort actions have no rights of direct action against defendants' liability carriers, and any such right must be created by the

legislature. Major, 267 S.C. at 520, 229 S.E.2d at 850; Swinton v. Chubb & Son, Inc., 283 S.C. 11, 14, 320 S.E.2d 495, 496 (Ct. App. 1984). Moreover, insurance issues must be kept from the jury to avoid prejudicing the verdict. Bartell v. Willis Constr. Co., 259 S.C. 20, 24, 190 S.E.2d 461, 463 (1972); Rule 411, SCRE.

Coverage issues are often resolved as part of the settlement of the underlying construction defect actions. But when coverage is contested, liability carriers allow retained defense counsel to defend the insured contractor without regard to any coverage defenses. Insurers retain separate coverage counsel to represent them in coverage disputes. In order to protect the integrity of the underlying tort proceeding and to prevent conflicts of interests for defense counsel, insurance coverage issues are usually litigated in separate declaratory judgment actions.

B. The Harleysville opinion and its change in the law

On January 11, 2017, the Supreme Court issued an opinion that re-wrote the law governing insurance coverage disputes. The court affirmed on most issues the ruling of a special referee, John A. Milling. The special referee's order ignored and disregarded prior South Carolina law on numerous points, and instead followed a patchwork of inapposite precedent from other jurisdictions. The special referee ignored longstanding black letter law that insurance coverage cannot be created by waiver or estoppel. Laidlaw Envtl. Servs. (TOC), Inc. v. Aetna Cas. & Sur. Co. of Illinois, 338 S.C. 43, 53, 524 S.E.2d 847, 852 (Ct. App. 1999). Additionally, the special referee ruled that a liability carrier may not "re-litigate damages" in a separate coverage action. Harleysville Group Ins. v. Heritage Cmties., Inc., 2013 WL 8482326 at *14 (S.C. Com. Pl. filed Feb. 28, 2013), aff'd, 2017 WL 105021 at *7 n.11 (petition for rehearing pending).

The Supreme Court, affirming the reasoning of the special referee, held that a liability insurer waives coverage defenses by failing to include in its reservation of rights letters notice that a conflict of interest exists and that an allocation of damages between covered and non-covered losses is needed. Harleysville, 2017 WL 105021 at *7. These actions would have been meaningless and counterproductive under prior South Carolina law because they are based upon conflicting law from other jurisdictions that merge insurance issues with tort issues.

Some jurisdictions place the burden of proving the precise portion of the unallocated verdict that is covered on the plaintiff in the underlying tort action. Duke v. Hoch, 468 F.2d 973, 977 (5th Cir. 1972). This concept was foreign to South Carolina law, which allowed the parties to the underlying action to produce evidence of covered damages in a separate coverage action. See Braswell v. Faircloth, 300 S.C. 338, 387 S.E.2d 707 (Ct. App. 1989) (allocating covered versus non-covered damages in a coverage action based upon damages awarded in a separate liability action). Because South Carolina courts have allowed contractual allocation of covered versus non-covered damages to occur in a separate coverage action, there was no reason to advise the insured of the need for such an allocation in the underlying tort action under prior law.

The circumstances under which Duke and its progeny arose are very different from the facts of this case. The policy in Duke covered negligence but not intentional misconduct. Id. at 975. The plaintiff's claim against the insured accountants included claims for negligence and intentional acts. Id. Generally, the claims involved negligent failure to keep proper books and records and intentional commingling of funds. Id.

No one requested an allocated verdict at trial. Duke, 468 F.2d at 975. The jury returned an unapportioned verdict. Id.

The plaintiff then brought suit to recover on the defendants' liability policy. Duke, 468 F.2d at 977. Under Florida law, if the insurer established that the underlying judgment was for both covered and non-covered damages, the burden shifted to the plaintiff to prove the precise portion of the unallocated verdict that was covered. Duke, 468 F.2d at 977. The insurer argued that due to the lack of an allocated verdict, the plaintiff failed to meet his burden and therefore he was not entitled to recovery under the policy for the judgment. Id.

The court held that permitting the insurer to make this argument placed the plaintiff in an unfair position. It was impossible for the plaintiff to recover because the insurer, in control of the defense, could avoid coverage simply by failing to obtain an allocated verdict. Duke, 468 F.2d at 979. The court relieved the plaintiff of an impossible burden of proof by holding that the insurer waived this coverage defense by failing to notify its insured of the conflict of interest and the need to obtain an allocated verdict. Id. at 979-80.

Duke addressed a legal scenario in which (a) governing law did not permit an allocation of the underlying verdict, and (b) the insurer argued that the plaintiff could not meet his burden of proving the extent of covered damages due to the lack of an allocated verdict. Duke, 468 F.2d at 977. Duke and its progeny do not stand for the proposition that an insurer forfeits all coverage defenses merely by failing to instruct defense counsel to obtain an allocated verdict. Rather, these cases hold that an insurer cannot use its failure to obtain an allocated verdict as an excuse to deny coverage. See Duke, 468 F.2d at 977; Remodeling Dimensions, Inc. v. Integrity Mut. Ins. Co., 819 N.W.2d 602, 610 (Minn.

2012). Furthermore, Duke was decided in a state that permitted an insurer to intermingle coverage issues with tort issues in the underlying tort action by instructing retained defense counsel to request an allocated verdict.

In contrast, courts applying South Carolina law have held that defense counsel retained by a liability insurer does not have an inherent conflict of interest because defense counsel's loyalty is solely to the insured contractor. Twin City, 336 F. Supp. 2d at 615-16, aff'd, 433 F.3d at 373-74. Because defense counsel is ethically bound to the insured contractor, there was no reason to advise the insured of a conflict of interest. It would have created a conflict of interest where none existed for an insurer to advise defense counsel to seek an allocation of covered versus non-covered damages in the underlying action because neither the plaintiff nor the insured contractor has an interest in such an allocation in the underlying action.

Furthermore, the special referee in Harleysville merged coverage issues with the defense by ruling that a general verdict cannot be "re-litigated" in a separate coverage action. Harleysville, 2013 WL 8482326 at *14-17. This concept was incongruous with South Carolina jurisprudence, which up to that time had always allowed coverage issues to be litigated in separate actions. See Auto Owners Ins. Co. v. Personal Touch Med Spa, LLC, 763 F. Supp. 2d 769, 775-76 (D.S.C. 2011) (holding that a federal district court may decide coverage issues without becoming entangled in underlying tort issues); Crossmann Cmties. of N.C., Inc. v. Harleysville Mut. Ins. Co., No. 4:09-CV-1379-RBH, 2013 WL 5437712 (D.S.C. filed Sept. 27, 2013) (making findings of fact and drawing legal conclusions in allocating covered versus non-covered damages in a separate coverage action in federal court).

All of these rulings are based on paradigm shift away from former South Carolina law. The court's reasoning in Harleysville makes sense only if the liability insurer is viewed as a litigant in the underlying tort action. This concept, however is inconsistent with prior law in this state that separated coverage issues from underlying tort issues.

C. Prior cases did not require an insurer to intervene.

The two cases cited in Harleysville did not forecast that the general rule that coverage issues may be litigated in a separate action had been abandoned. See Harleysville, 2017 WL 105021 at *7 n.11. The Supreme Court cited two cases in support of its holding that Harleysville waived its right to contest coverage issues by failing to seek an allocated verdict. See id. (citing Auto Owners Insurance Company v. Newman, 385 S.C. 187, 684 S.E.2d 541 (2009); Owners Ins. Co. v. Clayton, 364 S.C. 555, 614 S.E.2d 611 (2005)).

1. Newman did not require intervention

In Newman, the court held that Auto-Owners could not relitigate the issue of damages because it "represented [its insured] in binding arbitration, made mandatory by the terms of the insurance contract." Newman, 385 S.C. at 198 n.5, 684 S.E.2d at 547 n.5. The court held that Auto-Owners "had an opportunity to raise this matter when the issue of damages was litigated before the arbitrator . . . ." Id. at 198, 684 S.E.2d at 547.

This language indicated that Newman addressed a special situation. First, insurance companies cannot "represent" their insureds before courts of record. Renaissance Enters., Inc. v. Summit Teleservs., Inc., 334 S.C. 649, 515 S.E.2d 257 (1999). Second, it is unusual for a liability insurer to invoke an arbitration provision in its policy in the underlying construction defect action. Typically, it is the builder who moves to compel arbitration. See Carlson v. S.C. State Plastering, LLC, 404 S.C. 250, 254-56, 743 S.E.2d 868, 870-71

(Ct. App. 2013) (indicating that the developer moved to compel arbitration based upon an arbitration provision in their purchase agreement).

Furthermore, the court found that the insurer "had an opportunity to raise this matter" in the underlying tort action. Insurers are not technically parties to underlying lawsuits simply because they provide a defense. 2 Allan D. Windt, Ins. Claims & Disputes § 6:22 (6th ed. Mar. 2017 Update). Liability insurers may not be joined as parties in tort actions with their insured defendants, nor may insurance issues be raised in those proceedings. Major v. Nat'l Indem. Co., 267 S.C. 517, 520, 229 S.E.2d 849, 850 (1976); Trancik v. USAA Ins. Co., 354 S.C. 549, 554, 581 S.E.2d 858, 861 (Ct. App. 2003); Rule 411, SCRE. The Supreme Court has squarely held that insurers may not intervene in underlying actions that affect their interest. Ex Parte Gov't Emp's. Ins. Co., 373 S.C. 132, 137, 644 S.E.2d 699, 702 (2007).

Thus, Newman's holding was based upon a factual determination that Auto-Owners was a party to the underlying arbitration proceeding. Whether Auto-Owners was actually a party to the underlying action is irrelevant. The Court's holding found as a matter of fact that Auto-Owners was a party to the underlying litigation, and that finding was apparently never challenged. Because Newman was itself decided in the context of a coverage action that was separate from the underlying proceeding, and the particular holding at issue was based upon the specific facts of that case, there was nothing to indicate that it was intended to create a categorical rule that insurance issues cannot be decided in separate coverage actions.

Harleysville focuses on the "right to control the litigation." Harleysville, 2017 WL 105021 at *6. This is inconsistent with prior law because, as discussed above, insurers

retain defense attorneys whose loyalty is solely to the insured. Twin City, 336 F. Supp. 2d at 615-16, aff'd, 433 F.3d at 373-74. Consequently, insurers cannot instruct defense counsel to inject coverage issues into the underlying tort action.

2. Clayton did not require intervention.

The other case cited in Harleysville does not deal with coverage for construction defects. In Clayton, the Court held that coverage existed because one of two theories of liability was covered. Id. at 560, 614 S.E.2d at 614.

Clayton addressed substantively different policy language. The policy at issue in Clayton covered certain causes of action, including defamation. Id. at 560, 614 S.E.2d at 614. There was no qualifying language in that policy provision limiting coverage for defamation claims to certain types of injuries or damage. Thus, a finding that one of the causes of action was covered "answer[ed] the coverage question." Id. at 561, 614 S.E.2d at 614. Clayton avoids the issue addressed in Duke by preventing the insurer from arguing that only a portion of the verdict was covered. See 468 F.2d at 975-76.

Coverage for construction defects does not follow the same analysis because, under the policy language and longstanding law, coverage exists for only a portion of the damages awarded for negligent construction—those damages awarded for accidental water damage, as opposed to defective construction. Crossmann, 395 S.C. at 50, 717 S.E.2d at 594; see also C.D. Walters Constr. Co., Inc. v. Fireman's Ins. Co. of Newark, N.J., 281 S.C. 593, 316 S.E.2d 709 (Ct. App. 1984) (holding that "the comprehensive general liability policy does not cover faulty workmanship, but rather faulty workmanship which causes an accident"). This distinction is not merely required by the policy language and case law, it is mandated by statute. S.C. Code Ann. § 38-61-70(B). Courts must presume that statutes

are not futile acts, but were intended to accomplish something. State ex rel. McLeod v. Montgomery, 244 S.C. 308, 314, 136 S.E.2d 778, 782 (1964).

Thus, the fact that a general verdict was rendered in the underlying construction defect case does not "answer the coverage question" as it does with defamation claims. See Clayton, 364 S.C. at 560, 614 S.E.2d at 614. The question is not whether one of the causes of action is covered, but how much of the damages awarded on the otherwise covered cause of action (*i.e.,* negligence) is for repair of accidental water damage. Crossmann, 395 S.C. at 50, 717 S.E.2d at 594. The policy language and South Carolina law require a separate allocation to determine how much of the damages awarded in the underlying case are covered under the insurance contract.

D. "Relitigation" of coverage issues was permitted under prior law.

Harleysville's application of Clayton ignored a large body of prior law. Generally, an insurer is bound by the underlying judgment only when it was given full opportunity to control the defense. 2 Ins. Claims & Disputes § 6:22. An insurer is not collaterally estopped as to facts that were not adjudicated in the underlying lawsuit against the insured. Id. Moreover, an insurer is not collaterally estopped when the interests of the insurer conflict with those of the insured. Id. South Carolina has adopted this legal framework, and none of these factors weigh in favor of precluding an insurer from litigating coverage issues in separate proceedings.

1. Opportunity to control the defense

First, liability insurers do not have "full opportunity to control the defense" under South Carolina law. Instead, they provide defense counsel whose sole loyalty is to the insured. Twin City, 433 F.3d at 373-74. Heretofore, liability insurers addressed coverage

issues in separate actions through separate counsel. Therefore, liability carriers in South Carolina do not "control the defense" to the extent that they could be held to have waived coverage defenses in the underlying case.

2. Rules of collateral estoppel

Second, collateral estoppel generally does not apply in the context of coverage disputes involving construction defect litigation. This is so for two reasons. First, the interests of liability insurers generally conflict with those of their insureds with respect to the amount of covered damages. Second, the factual determinations affecting the coverage issues are not adjudicated in the underlying tort actions.

In South Carolina Property and Casualty Insurance Guaranty Association v. Wal-Mart Stores, Inc., 304 S.C. 210, 403 S.E.2d 625 (1991), the Supreme Court adopted the Restatement (Second) of Judgments rule for the use of offensive collateral estoppel. Id. at 213, 403 S.E.2d at 627. Under this rule, only a party to a prior action or a one in privity with a party to a prior action can be precluded from relitigating an issue by collateral estoppel. Carrigg v. Cannon, 347 S.C. 75, 80, 552 S.E.2d 767, 770 (Ct. App. 2001). Privity exists when one party is "so identified in interest with another that he represents the same legal right." Id. "Privity deals with a person's relationship to the subject matter of the previous litigation, not to the relationships between the entities." Wade v. Berkeley County, 330 S.C. 311, 317, 498 S.E.2d 684, 687 (Ct. App. 1998). "To be in privity, a party's legal interests must have been litigated in the prior proceeding." Id. Although liability insurers provide a defense, they are not in privity with their insureds with respect to coverage issues.

a. Conflict of interest

Under the Restatement rule, an indemnitor may be precluded from relitigating an issue if the indemnitor defended or should have defended the indemnitee. Restatement (Second) of Judgments § 57(1) (1982). However, when there is a conflict of interest between the indemnitor and the indemnitee, the indemnitor is not bound. Restatement (Second) of Judgments § 57(2) (1982).

Under prior South Carolina law, an insurer was not bound by the findings of fact in the underlying judgment when its interests conflicted with those of its insured. Sims v. Nationwide Mut. Ins. Co., 247 S.C. 82, 145 S.E.2d 523 (1965). In Harleysville, the court held that the insurer waived its right to contest coverage by failing to advise of a potential conflict of interest. Harleysville, 2017 WL 105021.[3] Reservation of rights letters advise the insured of a conflict as to an insurer's duty to indemnify. Id. at *5. Nevertheless, after finding a conflict of interest, the court ignored its own precedent in holding that Harleysville was bound by the underlying judgment. See Sims, 247 S.C. at 86, 145 S.E.2d at 525. This abrupt reversal could not have been forecasted prior to Harleysville.

b. Coverage issues differ from tort issues

Furthermore, coverage questions, although they relate to the settlement or judgment that may be awarded against the insured contractor in the underlying tort action, are generally separate and distinct from the question of proximately caused damages in the tort action. See Magnolia North Prop. Owners' Ass'n, Inc. v. Heritage Cmties., Inc., 397 S.C.

[3] As discussed above, this conflict generally does not affect the defense of the underlying action under South Carolina's system because insurers reserve their rights to adjudicate coverage disputes in separate actions. The conflict of interest is limited to the amount of covered damages for purposes of the insurer's duty to indemnify.

348, 363-64, 725 S.E.2d 112, 120-21 (Ct. App. 2012). The issue in the coverage action is not whether the tort plaintiff was damaged and to what extent, but rather how much of the damages awarded in the underlying case are covered under the insurance contract. S.C. Code Ann. § 38-61-70; Crossmann, 395 S.C. at 50, 717 S.E.2d at 594; Auto Owners, 763 F. Supp. 2d at 775-76. The parties to the underlying case have no incentive to present evidence and arguments as to the quantum of the plaintiff's damages that is for resulting water damage as opposed to faulty work. See Rule 49(b), SCRCP (providing that special interrogatories must be "necessary to a verdict").

The Supreme Court has also held that the binding effect of a judgment against an insured does not extend to matters outside the scope of an insurance contract. Sims v. Nationwide Mut. Ins. Co., 247 S.C. 82, 86, 145 S.E.2d 523, 525 (1965). "To hold otherwise would be to estop the Insurance Company by the acts of parties in a transaction in which it has no concern and over which it has no control, and to deprive it of its day in court . . . ." Id. For this reason, insurers are allowed to reserve their defenses for a subsequent suit. Farm Bureau Mut. Auto. Ins. Co. v. Hammer, 177 F.2d 793, 800 (4th Cir. 1949).

3. Due Process requirements

Harleysville assumed that insurers must address coverage issues in the underlying tort actions without providing any mechanism for coverage issues to be heard and ruled upon. Insurance carriers, which have the same access to the courts as any other jural persons, are entitled to seek declaratory relief as to meritorious coverage issues. Greene v. Dunham Life Ins. Co., 287 S.C. 197, 199, 336 S.E.2d 478, 479-80 (1985) (holding that insurers should not be penalized for litigating a meritorious issue); Sims, 247 S.C. at 86,

145 S.E.2d at 525 (holding that insurers may not be deprived of their day of court through the actions of others).

Collateral estoppel only applies if the party to be estopped had a full and fair opportunity to litigate the issue in the first action. Beall v. Doe, 281 S.C. 363, 370, 315 S.E.2d 186, 190 (Ct. App. 1984). This rule is imposed to protect the constitutional due process rights of the party to be estopped. Richburg v. Baughman, 290 S.C. 431, 435, 351 S.E.2d 164, 434 (1986).

Due process requires that liability insurers be provided a proper forum for resolving coverage disputes. Garris v. Governing Bd. of S.C. Reinsurance Facility, 333 S.C. 432, 444, 511 S.E.2d 48, 54 (1998) (holding that due process requires notice and an opportunity to be heard). Due process cannot countenance a ruling that, on the one hand, insurers must sacrifice their interests to those of the insured in defending the underlying tort action, while at the same time, insurers waive any rights to assert coverage issues by failing to assert them in that same proceeding. See Harleysville, 2017 WL 105021 at *5-6

E. The effect of Harleysville

Accordingly, the Harleysville opinion, if it becomes final, will bring about a profound change in the legal landscape upon which insurance issues are to be decided. It amounted to a wholesale refashioning of the law on a scale normally reserved for the legislature. See Swinton v. Chubb & Son, Inc., 283 S.C. 11, 14, 320 S.E.2d 495, 496 (Ct. App. 1984) (holding that a right of direct action must be created by the legislature). Harleysville held, for the first time, that coverage can be created by waiver or estoppel, and that insurers waive coverage defenses by failing to take actions that were totally inconsistent with prior law. Harleysville also ignored the distinction between South

Carolina jurisprudence and conceptual frameworks followed by other jurisdictions that merge liability insurance issues with underlying tort issues. As Acting Justice Pleicones recognized in his dissent, "there is no suggestion as to how Harleysville could have intervened in these lawsuits and asserted a defense against coverage without creating an impermissible conflict of interest in violation of established South Carolina law." Harleysville, 2017 WL 105012 at *17 (Pleicones, A.J., dissenting).

F. Harleysville requires an insurer to move to intervene.

As discussed above, the effect of Harleysville is that it places liability insurers in a position in which they must move to intervene in the underlying case or they waive all rights under their contracts of insurance. Under prior law, it was doubtful that insurers even had standing to intervene. Ex Parte Gov't Employee's Ins. Co., 373 S.C. 132, 138-39, 644 S.E.2d 699, 702-03 (2007); Baker Hosp. v. Fireman's Fund Ins. Co., 314 S.C. 98, 101, 441 S.E.2d 822, 823 (1994) (citing Blue Cross and Blue Shield of S.C. v. S.C. Indus. Comm'n, 274 S.C. 204, 262 S.E.2d 35 (1980)). At a minimum, an insurer could not be said to have waived all coverage defenses when a separate declaratory action had been filed to determine coverage issues. By merging coverage with tort issues and holding that insurers waive all rights by not asserting them in the underlying tort case, Harleysville forces insurers to move to intervene to seek an allocated verdict. Nationwide properly moved to intervene based upon a change in law. For this reason, Nationwide's motion to intervene was timely.

G. The trial court erred in ruling that Nationwide's Motion to Intervene was untimely.

As discussed above, Harleysville represents a significant change in South Carolina law. Because the opinion appears to hold that insurers are barred from litigating factual

issues that are intertwined with the underlying tort litigation in separate coverage actions, liability insurers now have no choice but to move to intervene in the underlying tort litigation. A holding that insurers lack standing to intervene would deny insurers a forum in which to litigate such coverage issues, thus violating due process.

Accordingly, Nationwide moved to intervene in this action shortly after the Harleysville opinion was released. The scope of the requested intervention was limited. Nationwide sought only to participate in the drafting of a special verdict form or submission of special interrogatories to the jury regarding the amount of any damages award that is for defective work as opposed to resulting damage to building components outside Superior Solution's scope of work. (See Motion to Intervene.)

Under South Carolina law, a party seeking intervention under Rule 24(a)(2), SCRCP, must: (1) establish timely intervention; (2) assert an interest relating to the property or transaction which is the subject of the action; (3) demonstrate that it is in a position such that without intervention, disposition of the action may impair or impede its ability to protect that interest; and (4) demonstrate that its interest is inadequately represented by other parties. In re Horry County State Bank, 361 S.C. 503, 508, 604 S.E.2d 723, 725 (Ct. App. 2004).

Nationwide's motion to intervene was timely. As discussed above, grounds did not exist for seeking intervention until the Harleysville opinion was released on January 11, 2017. Nationwide's motion was filed approximately two weeks later—a short time period that was barely sufficient for counsel to digest the significance of the Harleysville decision and prepare briefing on the matter. The remaining elements were also satisfied.

H. Other requisite elements for intervention

Nationwide has an interest relating to the property or transaction which is the subject of this action. As discussed above, this action represents the only forum in which Nationwide can obtain an allocation as to the amount of covered damages under the Policies.

Nationwide is in a position such that, without intervention, disposition of this action will impair or impede its ability to protect that interest. The Supreme Court has held that if intervention is not sought, an insurer waives its right to seek an allocation as to the amount of covered damages. Harleysville, 2017 WL 105021 at *7 n.11; Newman, 385 S.C. at 198, 684 S.E.2d at 547.

Nationwide is not adequately represented by other parties to this action. None of the parties to this action have an incentive to seek an allocation as to the amount of covered damages. The interests of the plaintiff and Superior Solution are aligned against the interest of Nationwide. Indeed, federal courts often realign parties to coverage litigation to reflect the fact that the interests of the liability carrier are adverse to the interests of both the plaintiffs and the defendants in the underlying tort litigation. See Bi-Lo, LLC v. Nat'l Union Fire Ins. Co. of Pittsburgh, C.A. No. 0:14-cv-00335-CMC, 2014 WL 12605522 at *7-8 (D.S.C. Apr. 30, 2014). When the interests of the party seeking intervention are adverse to the interests of the party litigants, "there is an obvious lack of adequate representation." In re Horry Bounty State Bank, 361 S.C. at 509, 604 S.E.2d at 726.

Accordingly, Nationwide satisfied all of the elements for intervention of right under Rule 24(a)(2). The use of the mandatory term "shall be permitted to intervene"

demonstrates that this right is not subject to a court's discretion. The trial court therefore erred in refusing to allow Nationwide to intervene.

In the alternative, Nationwide also moved to intervene under Rule 24(b). Permissive intervention is allowed at the court's discretion based upon the existence of a common question of fact or law between the underlying litigation and the intervenor's claims or defenses. S.C. Tax Comm'n v. Union County Treasurer, 295 S.C. 257, 263, 368 S.E.2d 72, 75 (Ct. App. 1988). Sound administrative procedure favors the disposition of all claims or defenses in a single action. Id. As discussed above, this action represents the only forum in which an allocation of covered versus non-covered damages can be made.

Nationwide's motion to intervene was made for the limited purpose of presenting the jury with a special verdict or special interrogatories for a finding as to allocation between covered and non-covered damages. Courts have allowed limited intervention for a special purpose. Davis v. Jennings, 304 S.C. 502, 504, 405 S.E.2d 601, 603 (1991) (holding that intervention is appropriate for third-party challenges to protective orders).

The granting of Nationwide's motion to intervene would not have unduly delayed or prejudiced the adjudication of the rights of the original parties because intervention was sought only for the limited purpose of determining the form of the verdict to be submitted to the jury, and the proposed intervention not have impacted the ability of the original parties to present their claims and/or defenses at trial. The remaining issues could be addressed in the pending coverage actions.

Nationwide properly moved to intervene in this action pursuant to Rule 24(a) and (b) for the limited purpose of participating in the drafting of a special verdict or submitting special interrogatories to the jury in order to obtain findings of fact necessary for an

allocation between covered and non-covered damages under the Policies. The motion was timely because it was filed shortly after a Supreme Court opinion was issued holding that insurers waive their rights by failing to take this action. Therefore, the trial court erred in refusing to grant Nationwide's motion to intervene.

II. If Nationwide's Motion to Intervene is granted, guidance is needed as to the scope of the intervention and associated procedural matters.

Even if Nationwide prevails on its motion to intervene, it is placed at a severe disadvantage. Under the Harleysville formulation, an insurer must request special interrogatories or a special verdict form to be presented to the jury. Harleysville, 2017 WL 105021 at *6. However, no discovery has been conducted on the issue of covered versus non-covered damages in this action, and no evidence or arguments on this issue will be presented to the jury. The jury is asked to render a verdict upon an entirely extraneous issue in an apparent violation of Rule 49(b), SCRCP (providing that special interrogatories must be "necessary to a verdict").

When Nationwide moved to intervene in this action, it was immediately met with requests by the HOA for written discovery and a deposition of Nationwide representatives. The proposed topics for the deposition were wide-ranging and included issues currently being litigated in two separate coverage actions. (See Motion for a Protective Order at pp. 4-5 and Exh. B.) The HOA argued to the trial court that an insurer is not permitted to intervene on a limited basis. (Transcript of Record at p. 57.) The HOA took the position that upon a motion to intervene it is entitled to develop evidence of liability insurance to be used for purposes other than negligence such as bias of a witness. See Yoho v. Thompson, 345 S.C. 361, 548 S.E.2d 584 (2001); Rule 411, SCRE. At a status conference, Nationwide argued that if such discovery is permitted, Nationwide should also be allowed

to retain its own expert for the purpose of directly establishing the amount of covered versus non-covered damages in the underlying construction defect action, as opposed to being forced to rely on the factfinding in a separate action.

The trial court did not have the opportunity to rule on these issues because Nationwide's Motion to Intervene was not granted. However, if the trial court's ruling is reversed on appeal, these issues will immediately present themselves. They are novel issues that come into play only as a result of the Harleysville decision. Therefore, in the interest of judicial economy, Nationwide requests guidance as to how the bench and bar are to proceed.

CONCLUSION

Nationwide's position is that this action is not a proper forum for litigating coverage issues. However, if the Harleysville opinion becomes final, due process requires that Nationwide be provided a forum for developing evidence and a receiving a meaningful hearing as to allocation between covered versus non-covered damages. In order to avoid a waiver, Nationwide's only choice was to move to intervene in this action for the limited purpose of drafting and submitting special interrogatories or a special verdict form. Nationwide's motion was timely because it was filed approximately two weeks after the Harleysville decision was handed down. The other requirements for intervention are all met. Therefore, the trial court erred in refusing to grant Nationwide's motion.

In the interest of judicial economy, Nationwide also requests guidance as to how to proceed under the new framework created by Harleysville. The combining of liability insurance issues with underlying tort issues creates numerous questions for which there is currently no governing law. Questions regarding scope of the intervention, proper

procedure, permitted discovery, permissible use of evidence developed in this case, and effect of this case on other pending coverage actions related to this case have already been raised. The trial court has no governing law upon which to base any ruling on these disputed matters.

In the event the Harleysville opinion is reversed on rehearing, this appeal may become moot. However, if Harleysville becomes final in its present form, the trial court's denial of Nationwide's Motion to Intervene was in error and should be reversed. In the interest of judicial economy, Nationwide also requests guidance as to how to proceed in light of the issues that have been raised in this case if it is allowed to intervene.

Respectfully submitted,

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Columbia, South Carolina
May 24, 2016

IN THE STATE OF SOUTH CAROLINA

In the Court of Appeals

APPEAL FROM BERKELEY COUNTY
Court of Common Pleas

Kristi Lea Harrington, Circuit Court Judge

Case No. 2013-CP-08-00179

RECEIVED
MAY 24 2017
SC Court of Appeals

Ex Parte:

Nationwide Mutual Fire Insurance Company, ...Appellant,

In Re:

Beresford Commons Homeowners Association, Inc.,.....Respondent,

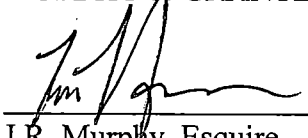
v.

Superior Solution, LLC, ...Respondent.

CERTIFICATE

I, Timothy J. Newton, Esquire, attorney for Appellant, certify that the Appellant's Brief complies with the South Carolina Supreme Court Order of August 13, 2007 and Rule 211(b) of the South Carolina Court Rules.

MURPHY & GRANTLAND, P.A.



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PROOF OF SERVICE

I certify that I have served the Appellant's Initial Brief and Designation of Matter, via regular and electronic mail, on May 24, 2017, to its attorneys of record to the following attorneys of record:

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May 23, 2017

RECEIVED
MAY 24 2017
SC Court of Appeals

HAND DELIVERED
The Honorable Jenny Abbot Kitchings
Clerk of Court
South Carolina Court of Appeals
Post Office Box 11629
Columbia, SC 29211

Re: Beresford Commons HOA, Inc. vs. Penuel Construction, LLC aka Superior, et al.
Civil Action No.: 2013-CP-08-00179
Claim No.: 61 39 AC 221437
Insured: Superior Solution, LLC
Our File No.: 1150-0740

Dear Ms. Kitchings:

Enclosed please find herewith for filing with the Court the original and six (6) copies of Appellant's Initial Brief and Designation of Matter in the above-referenced matter. I would appreciate your filing the original and returning the clocked copies to me by individual delivering same provided. By copy of this letter I am serving same on opposing counsel.

As always, I thank you and your staff for all the help and assistance you repeatedly provide with regard to these matters.

Sincerely,

Timothy J. Newton

TJN/sb
Enclosures

cc: Amanda Blundy, Esquire
Phillip W. Segui, Jr., Esquire
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